No. 386

In the Supreme Court of the United States

OCTOBER TERM, 1963

FEDERAL POWER COMMISSION,
Petitioner,

vs.

TEXACO INC. AND PAN AMERICAN PETROLEUM CORPORATION,
Respondents.

On Writ of Certiorari to the United States Court of Appeals for the Tenth Circuit

Motion of the People of the State of California and the Public Utilities Commission of the State of California for Leave to File Brief Amici Curiae in Support of Petitioner, and Brief Amici Curiae

RICHARD E. TUTTLE
Chief Counsel

J. CALVIN SIMPSON
Senior Counsel

JOHN T. MURPHY
Associate Counsel

5072 State Building
San Francisco 2, California

Attorneys for the People of the State of California and the Public Utilities Commission of the State of California

February 7, 1964

SUBJECT INDEX

2

2

TABLE OF AUTHORITIES CITED

In the Supreme Court of the United States

OCTOBER TERM, 1963

No. 386

FEDERAL POWER COMMISSION, *Petitioner,* vs. TEXACO INC. AND PAN-AMERICAN PETROLEUM CORPORATION, *Respondents.*	

On Writ of Certiorari to the United States Court of Appeals for the Tenth Circuit

Motion of the People of the State of California and the Public Utilities Commission of the State of California for Leave to File Brief Amici Curiae in Support of Petitioner

---

The People of the State of California and the Public Utilities Commission of the State of California (California), through their Attorney and Chief Counsel, pursuant to Rule 42 of the Revised Rules of the Supreme Court of the United States, respectfully move for leave to file, in the above-entitled case, their brief amici curiae, annexed hereto, which supports the position of the Federal Power Commission, petitioner herein.

The Attorney and Chief Counsel for the Public Utilities Commission of the State of California is charged with the duty and

responsibility of representing and appearing for the People of the State of California and the Public Utilities Commission of said State in all matters concerned with public utility regulation (Section 307, California Public Utilities Code).

Of direct concern to the State of California is the issue in this case relating to the power of the Federal Power Commission (Commission) to prohibit, by way of its rule-making authority, contractual arrangements which it finds incompatible with the public interest. The interest of California, the largest natural gas consuming state in the nation, in an adequate supply of natural gas at just and reasonable prices has been constantly frustrated by the incessant "triggering" of indefinite price changing provisions in gas sales contracts. California played a prominent and significant role in the litigation which lead to Commission's prohibitions against indefinite escalation clauses. See *The Pure Oil Co.*, 25 FPC 383 (1961), affirmed *The Pure Oil Co. v. Federal Power Commission*, 299 F.2d 370 (7th Cir. 1962). California's efforts to bring about the elimination of indefinite escalation clauses have been continuing and consistent. See *Shell Oil Co.*, FPC Dkt. No. RI61-515, Opinion No. 382, issued March 15, 1963.

California brought the issue of indefinite escalation clauses to this Court in *Wisconsin v. Federal Power Commission*, 373 U.S. 294, 303-304 (1963). The issue was dismissed on procedural grounds. This case presents an opportunity for this Court now to consider the issue on the merits.

In this case, the petitioner primarily argues the scope of its rule-making power under Section 16 of the Natural Gas Act[1] and only incidentally the sound regulatory principles which compelled the petitioner to exercise its rule-making power. The brief which amici curiae are requesting permission to file contains an argument on the issue of the rule-making power as the necessary and

1. 52 Stat. 830, 15 U.S.C. § 717o.

appropriate means of outlawing contract provisions which are contrary to the public interest.

California submits the annexed brief on behalf of California consumers to urge that this Court recognize and approve the power of the petitioner to prohibit, through its rule-making authority, contractual provisions which it finds to be inconsistent with the public interest it is obligated to safeguard.

Respectully submitted,

RICHARD E. TUTTLE
Chief Counsel

J. CALVIN SIMPSON
Senior Counsel

JOHN T. MURPHY
Associate Counsel

Attorneys for the People of the State of California and the Public Utilities Commission of the State of California

February 7, 1964

In the Supreme Court of the United States

OCTOBER TERM, 1963

No. 386

FEDERAL POWER COMMISSION,	*Petitioner,*
vs.	
TEXACO INC. AND PAN AMERICAN PETROLEUM CORPORATION,	*Respondents.*

On Writ of Certiorari to the United States
Court of Appeals for the Tenth Circuit

Brief Amici Curiae on Behalf of the People of the State of California and the Public Utilities Commission of the State of California

---

INTRODUCTORY STATEMENT

California adopts such portions of the brief of the Federal Power Commission, petitioner herein, setting forth the Opinion Below, the Jurisdiction, the Question Presented, Statutes and Regulations Involved, and Statement of the Case.

The interest of California in this cause is fully set forth in the motion preceding this brief.

SUMMARY OF ARGUMENT

The indefinite escalation clauses contained in respondents' contracts are contrary to the public interest and violative of sound regulatory principles. The Commission has the right and duty to outlaw such provisions by its orders of general application. The decision of the Court of Appeals, in denying the Commission this power, destroys the beneficial effect the exercise of such power has had on price stability, and defeats the efforts of consumers to secure protection from excessive rates and charges.

ARGUMENT

The Proscription of Indefinite Escalation Clauses Is a Necessary and Appropriate Measure Demanded by Statutory and Regulatory Standards

Section 16 of the Natural Gas Act[2] empowers the Commission to make such rules and regulations as are "necessary or appropriate" to carry out the provisions of the Act. The "necessary or appropriate" language gives the Commission great latitude and broad discretion in setting down the rules and regulations which govern its functions. This power extends to procedural matters such as the orderly conduct of hearings and the proper form of filed documents; it extends to substantive matters such as the definition of parties within its jurisdiction and the issuance of temporary certificates in emergency situations. There must, however, always be a reasonable basis for the promulgation of any rule or regulation. *American Trucking Association, Inc. v. United States*, 344 U.S. 298, 314 (1953).

California will address itself to the salient reasons which compelled the Commission to proscribe indefinite escalation clauses. These reasons made the issuance of FPC Orders Nos. 232, 232A and 242 "necessary" and "appropriate" to fulfill the Commission's responsibility to implement the Natural Gas Act, and to protect the nation's consumers.

---

2. 52 Stat. 830, 15 U.S.C. § 717o.

1. The Indefinite Escalation Clause Is an Anachronism in the Circumstances of the Nation's Economy and the Commission's Scope of Regulation.

The origin of the indefinite escalation clause in producer-pipeline company contracts predates producer regulation. Such clause first generally appeared in natural gas contracts in the early 1940's at a time when pipeline companies were paying a few pennies for an Mcf of gas, when unsold gas was "flared" in the sky, and when the great Western markets and the giant interstate pipelines serving them did not exist. The clause was allegedly designed by the unregulated producers to protect themselves against any inflationary changes in the future.

From the 1940's to the 1960's the natural gas market changed radically. In 1961 the Commission, in the celebrated *Pure* case, found that:

> "purchasers of gas are numerous, consumer demand is strong, and buyers are competing early for available supplies of gas. In our judgment, in the light of continuing increases in the price of gas in recent years and the present high level of prices, escalation clauses such as Pure's have by now outlived whatever economic function they may have had." *The Pure Oil Co.*, 25 FPC 383, 391 (1961), affirmed *The Pure Oil Co. v. Federal Power Commission*, 299 F.2d 370 (7th Cir. 1962).

Vast natural gas markets have now developed across the nation. California alone purchases over 300 million dollars of interstate natural gas annually. A great natural gas industry, distinct from the oil and the petroleum products industries, has grown with these markets. Consequently, there no longer exist the so-called uncertainties of the 1940's. The nation's projected population and general growth have given certainty to the future of the industry.

The indefinite escalation clause, as an inflationary safeguard, is an anachronism today. Price can be *definitely* stated and fixed for the full term of a contract. The Commission, in the exercise of its judgment, has recognized this. Moreover, with the initiation of the

regulation of producers, the Commission is the overseer of "just and reasonable" rates and, as an expert body, is qualified to judge the inflationary or deflationary impact the future may have on long-term natural gas contracts.

The Commission has embarked upon an area rate program (See *Wisconsin v. Federal Power Commission,* 373 U.S. 294 (1963)), wherein individual company producer costs have been excluded in determining area prices. While the area program is only an experiment, indefinite escalation in individual contracts under individual circumstances is incompatible with the Commission's area approach.

2. Indefinite Escalation Clauses Result in a Monumental Administrative Burden, a Confused Regulatory Situation, and Chaotic Pricing.

Indefinite escalation clauses are patently inconsistent with proper administration and effective regulation. Whether or not a rate filing based on an indefinite escalation clause is contractually authorized is invariably a matter of dispute. Consequently, the Commission must in each instance initially decide if the escalation conditions provided in the contract have occurred. The Commission's files are inundated with rate increase applications premised on the "triggering" of indefinite escalation clauses, where the Commission must first delve into contract problems before reaching the merits of the applications.

In the *Pure* case, 25 FPC 383 (1961), where a favored nation clause[3] was involved, the Commission had to decide first if the clause had been activated under a complex factual situation. A special hearing was necessary for this purpose.

In *Phillips Petroleum Co.,* 24 FPC 537 (1960), the Commission was unable to decide two of Phillips' rate increases based on spiral

3. A favored nation clause provides that the producer may file for a rate increase whenever the pipeline company pays a higher price to another producer in a specified geographical area.

escalation clauses[4] because the increases were interrelated with the unsettled rates of a pipeline company. This Court, on reviewing the *Phillips* case, did not take action on the clauses themselves since the price issue was still open. *Wisconsin v. Federal Power Commission*, 373 U.S. 294, 303-304 (1963). The pipeline company's rates have since been determined, but the Commission must still ascertain, if it decides to give effect to the clauses, the amount of the rate increase at issue and then the merits of the increase. The dissenting opinion in the *Phillips* case stated that the spiral escalation clauses "should be completely outlawed by the Commission when the two Sec. 4(e) proceedings left pending are decided." *Wisconsin v. Federal Power Commission*, 373 U.S. 294, 331 (1963).

Actual experience with the clauses affords the best examples of the chaos they produce. In *Shell Oil Co., et al.*, FPC Dkt. No. RI61-515, Opinion No. 382, issued March 15, 1963[5] the Commission was faced with the following disturbing fact situation. West Texas Gathering Company sold gas to El Paso Natural Gas Company from the Permian Basin of Texas and New Mexico. This sale caused Sun Oil Company, Shell Oil Company, Hunt Oil Company and The Superior Oil Company to file for increased rates based on the asserted activation of their favored nation clauses. The above Shell and Hunt filings allegedly triggered favored nation clauses in other Superior and Sun contracts, and these companies made additional filings. Finally, Shell decided that some of its other favored nation contracts had been activated by its own former filings, and asked for still further rate increases. The Commission's opinion rejected all of the filings on the ground that they lacked contractual support, but the hearing required

4. Spiral escalation clauses provide that in the event the pipeline company buying from the producer receives a rate increase, the producer's price to the pipeline company shall be proportionally increased.

5. The matter is now on review before the United States Court of Appeals for the Third Circuit, Nos. 14431, 14434, 14506 and 14507.

13 days, 1962 pages of testimony, 43 exhibits and 50 items incorporated by reference to the Commission's files.

The *Shell* case points out the disastrous effect the successive and rapid activation of indefinite escalation clauses can have on price stability in a given area. A single filing triggered dozens of other filings. Moreover, it demonstrates the great administrative burden which would be placed upon the Commission if it were compelled to deal with indefinite escalation clauses on a case-by-case basis.

3. Indefinite Escalation Clauses Generate Rate Increase Filings Which Have No Relationship to the Requirements of the Company Seeking the Increase.

Indefinite escalation clauses induce rate increase applications to be filed which are in no sense predicated on the requirements of the producer at the time of the filings. The Natural Gas Act imposes upon producers the obligation to charge only justifiable rates[6]. A duty is placed upon the regulated producer to ask for rates it can justify on the basis of the proved requirements of the company. Where the only justification for a filing is the activation of some indefinite escalation provision in a contract by the ocurrence of some fortuitous event, the producer has no right to demand higher rates.

The United States Court of Appeals for the Ninth Circuit, when faced with substantially the same facts presented to the Tenth Circuit by the instant case, reached what California believes is the correct decision. The Court said:

> "In order No. 242, the Commission also referred to, and adopted, its conclusions stated in the *Pure Oil* case, 25 FPC

6. Section 4(a) of the Act provides: "All rates and charges made, demanded, or received by any natural-gas company for or in connection with the transportation or sale of natural gas subject to the jurisdiction of the Commission, and all rules and regulations affecting or pertaining to such rates or charges, shall be just and reasonable, and any such rate or charge that is not just and reasonable is hereby declared to be unlawful." 52 Stat. 822, 15 U.S.C. Sec. 717c(a).

> 383, with regard to the undesirable characteristics of such clauses. In its decision in that case, the Commission stated that such clauses are contrary to the public interest in a number of ways. They are, the Commission said, inherently unreasonable because they may be triggered by circumstances which have nothing to do with revenue needs or the reasonableness of rates. Moreover, the Commission determined in that case, such clauses have an injurious effect which cannot be fully overcome by resort to the refund provision of the Act:
>
> "In the light of these Commission determinations, and with due regard to the experience, expertise, and neutral position of the Commission as a regulatory agency, we find nothing in Superior's arguments advanced here which would warrant a holding that the Commission acted unreasonably, arbitrarily, or capriciously in proscribing the clauses involved in our case. * * *". *The Superior Oil Co. v. Federal Power Commission*, 322 F.2d 601, 620 (9th Cir. 1963).

The obligations of natural gas companies to file for rate increases only on the basis of their requirements and the duty of the Commission to protect consumers from increases which have no justification, demand that these indefinite pricing techniques be eliminated at least in future contracts, if not in all contracts.

CONCLUSION

The outlawing of indefinite escalation clauses is essential to the regulation of an industry affected with a public interest. Since producer regulation became a reality, such clauses have been suspect and the subject of Commission scrutiny. Orders Nos. 232, 232A and 242 represent Commission action taken, after thorough examination, to relieve a situation which was repugnant to the public interest.

California prays that this Court reverse the decision of the United States Court of Appeals for the Tenth Circuit.

Respectfully submitted,

RICHARD E. TUTTLE
Chief Counsel

J. CALVIN SIMPSON
Senior Counsel

JOHN T. MURPHY
Associate Counsel

Attorneys for the People of the State of California and the Public Utilities Commission of the State of California

February 7, 1964.